Supreme Court, U.S.
JUN 9 - 2010
OFFICE OF THE CLERK

No. 09-1176

IN THE
Supreme Court of the United States

PIRATE INVESTOR LLC AND FRANK PORTER STANSBERRY,

Petitioners,

v.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

THOMAS C. GOLDSTEIN
AKIN GUMP STRAUSS HAUER & FELD LLP
1333 New Hampshire Ave., NW
Washington, DC 20036

MATTHEW J. TURNER
14 West Mount Vernon Place
Baltimore, Maryland 21201

BRUCE W. SANFORD
Counsel of Record
BRUCE D. BROWN
LAURIE A. BABINSKI
BAKER & HOSTETLER LLP
1050 Connecticut Ave., NW
Washington Sq., Suite 1100
Washington, DC 20036
(202) 861-1500
bsanford@bakerlaw.com

June 9, 2010

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

TABLE OF CONTENTS

A. The punishment and enjoining of disinterested speech about the financial markets is an issue of far-reaching impact and critical significance that led the court of appeals to stay its mandate and warrants this Court's review 1

B. Certiorari is warranted because the decision below squarely presents conflicts under the First Amendment with decisions of this Court, other federal courts of appeal, and the Maryland Court of Appeals 7

C. All legal and factual issues are preserved..... 12

CONCLUSION 12

TABLE OF AUTHORITIES

Bose v. Consumers Union,
466 U.S. 485 (1984) 8, 9

Harte-Hanks Commc'ns v. Connaughton,
491 U.S. 657 (1989) 5, 7

Illinois ex rel. Madigan v. Telemarketing Associates, 538 U.S. 600 (2003) 10

Lowe v. SEC, 472 U.S. 181 (1985) 3

Lubin v. Agora, 882 A.2d 833 (Md. 2005) 11

Near v. Minnesota, 283 U.S. 697 (1931) 10

New York Times v. Sullivan,
376 U.S. 254 (1964) 7

Pittsburgh Press v. Pittsburgh Commission on Human Rel., 413 U.S. 376 (1973) 11

Rowinski v. Salomon Smith Barney,
398 F.3d 294 (3d Cir. 2005) 5

SEC v. Dorozhko, 574 F.3d 42 (2d Cir. 2009) 4

SEC v. Texas Gulf Sulphur, 401 F.2d 833
(2d Cir. 1968) 4

SEC v. Zandford, 535 U.S. 813 (2002) 2

Schneider v. State, 308 U.S. 147 (1939) 10

United States v. Bell, 414 F.3d 474
(3d Cir. 2005) 11

United States v. O'Hagan,
521 U.S. 642 (1997) 2

Vance v. Universal Amusement,
445 U.S. 308 (1980) 10

A. The punishment and enjoining of disinterested speech about the financial markets is an issue of far-reaching impact and critical significance that led the court of appeals to stay its mandate and warrants this Court's review.

The government attempts to justify an unprecedented prospective injunction on disinterested financial speech by basing liability under Section 10(b) on the premise that publishers enhance their reputations every time they publish facts or predictions that turn out to be true. This new theory of "reputational gain" as a predicate for a vast expansion of the SEC's jurisdiction into the publishing world was created by the court of appeals out of necessity when an admission by the government at oral argument left it bereft of any other theory of liability. No legal or factual authority exists for this new theory, and it conflicts with a long-standing theme in the First Amendment jurisprudence of this Court. As the numerous *amici* supporting certiorari attest, the single statement in an investment newsletter that serves as a basis for a sweeping injunction cannot be distinguished from the content of hundreds of mainstream publications which thousands of times a day deliver facts and insights about public companies. The "natural and foreseeable result" of those publications is that readers will act on the information and possibly "purchase ... stock." BIO 8. Under the government's theory, the more that readers reward a publisher reputationally with their loyalty over time and rely on its publications to make investment decisions, the more certain the publisher now falls under Section 10(b). Pet. 20. It would be a perverse result under

the Constitution to permit the ordinary operation of the marketplace of ideas to serve as a substitute for the statutory nexus Congress and this Court have always required for liability under the federal securities laws.

1. There is no merit to the government's contention that existing precedent supports the imposition of Section 10(b) liability on a speaker who neither trades in the relevant security nor bears a fiduciary duty to an investor who trades. Though disinterested speech may "affect" securities trading, it does not satisfy the statutory requirement that a covered statement must be made "in connection with" securities trading. Before the ruling in this case, the lower courts had followed this Court's direction to hew rigorously to the statutory text of the securities laws, including in order to protect the free speech interests that the ruling so significantly undercuts.

"When a disinterested publisher sells non-personalized investment advice, the transaction is complete regardless whether any securities are actually bought or sold." Brief of InvestorPlace Media, LLC, et al. 18. To meet the "in connection with" requirement, however, an alleged fraud based on a false statement must "require" securities trading or be "consummated" by it. *SEC v. Zandford*, 535 U.S. 813, 820-21 (2002); *U.S. v. O'Hagan*, 521 U.S. 642, 655-56 (1997); Pet. 9, 16-17. Section 10(b) thus does not apply to disinterested publishers, who are instead covered by common-law principles of fraud subject to the protections of the First Amendment.

The government attempts to brush away the statutory limitations established in *O'Hagan* and *Zandford* by arguing that in those cases the fraud was perpetuated by "nondisclosure" and this case consists of an "affirmative misrepresentation." BIO 11-12. But the same statutory text applies in both instances, and neither law nor logic supports exempting a misrepresentation from the requirement that the government prove either a breach of duty or trading by the defendant.

This long-understood reading respects both statutory and constitutional interests and is the only reading that is consistent with *Lowe v. SEC*, 472 U.S. 181 (1985), which employed the canon of constitutional avoidance to remove disinterested speech from the reach of federal securities regulation. This Court understood that readers would purchase or sell securities based on the advice in Lowe's newsletters, but it still read these publications out of the Investment Advisers Act because they did not provide information in the context of a fiduciary relationship and regulating them with prior restraints would thus create constitutional concerns.

The government argues to the contrary only by taking language from inapposite cases out of context. BIO 9, 12. According to respondent, courts deem it sufficient that "[t]he natural and foreseeable effect of petitioners' false statements of fact was to induce the recipients of those statements to purchase securities." BIO 13. That cannot be correct, because it would apply fully to the assertion that a report in any of the newspapers, broadcasts, books, cable shows, and

Internet sites disseminated daily by *amici* and other publishers contained a false statement of fact.

In reality, the government cites no case in which the "in connection with" requirement was satisfied when the defendant had neither traded securities nor breached a fiduciary duty. In *SEC v. Dorozkho*, 574 F.3d 42 (2d Cir. 2009), BIO 12, the defendant made misrepresentations to gain access to a computer network to purloin information that he used to trade securities. In *SEC v. Texas Gulf Sulphur*, 401 F.2d 833 (2d Cir. 1968), BIO 9-10, the "in connection with" element was met by the party's fiduciary breach, not its trading. In *all* of the cases respondent cites applying the *Texas Gulf* standard of a statement that would "cause reasonable investors to rely thereon," BIO 9, the defendants traded stocks or carried duties.

2. The government is left with the erroneous claim that this case can be distinguished because supposedly "purchases of USEC stock by early recipients of the Special Report facilitated petitioners' ongoing fraud by causing the stock's price to rise, an increase that petitioners touted in their subsequent e-mail solicitations." BIO 8.

The ruling below bullies past the record and all the statutory and constitutional authority in its way to reach the untenable premise that petitioners may be sued under Section 10(b) because they secured a "reputational gain" from their readers' stock trading. App. 29a. The complaint in this case never contended petitioners' initial publication of the Report was intended to spur, or in fact did spur, later

sales by increasing the price of USEC stock. The government put on no such proof. The district court made no such finding. The government did not argue "reputational gain" on appeal.[1] It was invented by the court of appeals after respondent admitted at oral argument that petitioners received no benefit from the securities trading of their readers. Pet. 15. In the face of this concession, the court of appeals created the "reputational gain" theory to supply the benefit from securities trading the government acknowledged did not exist.

No court has ever expanded Section 10(b) liability to statements by disinterested publishers that enhance reputation and future revenues. The case on which the court of appeals relied, *Rowinski v. Salomon Smith Barney*, 398 F.3d 294 (3d Cir. 2005), App. 27a-29a, is so wildly inapposite that the government does not even bother to cite it to this Court. If respondent's view is accepted, then all publishers of impersonal financial news and investment advice whose circulation has grown because they have published credible information in the past will also no longer be "disinterested" and will therefore be equally subject to SEC investigations into their editorial work and Section 10(b) enforcement actions and private suits. The theory of "reputational gain" offends the Constitution and must be rejected as have other similar pretexts for regulating speech. *See Harte-Hanks Commc'ns v.*

---

[1] Respondent had a different theory then: that disinterested speech could be regulated if it was a "virtual certainty" that readers would trade based on it. No court has ever applied this theory under Section 10(b) either.

Connaughton, 491 U.S. 657, 667 (1989) ("If a profit motive could somehow strip communications of the otherwise available constitutional protection, our cases from *New York Times* to *Hustler Magazine* would be little more than empty vessels.").

In addition, the court of appeals' theory is refuted by the evidence. Petitioners published the E-mail and the Report on May 13, 2002. The next morning, when they saw that the Report was popular among readers, they decided to offer it for republication to other editors at their parent company through a sharing of subscriber lists that is common in the publishing industry. App. 180a-181a. The notion that petitioners deliberately staggered the Report's publication so that different waves of readers would buy it (and USEC stock) on different days is unfounded and uninformed. Later in the week, as the price of USEC stock was unsurprisingly rising with media coverage of the approaching summit, petitioners revised the E-mail, as any publisher would, to keep it current and accurate. As Porter Stansberry wrote to a copy editor: "Please make sure that you *update* USEC in the weekend Blast that you send out. The stock will probably be near $9.00."

Contrary to the reasoning of the court of appeals, App. 26a-27a, the fact that petitioners pointed out to readers that the stock price had already increased could have made subsequent sales of the Report *less* likely, not *more*, as readers may have believed that the market had already incorporated the information and the opportunity for investing had past. The assertion that stock purchases "were necessary to

complete [petitioners'] fraudulent scheme," App. 41a, is thus nothing more than baseless speculation unsupported by any factual findings or the record. The first publication of the Report could not have been "in connection with" securities trading because petitioners had not yet established their "reputation" from the increase in the stock price. Equally essential to the court of appeals' theory is that the Report remained "material" for a week and a half as different groups of readers purchased it. But the securities expert, Pet. 10, confirmed at trial that material information about a NYSE-listed company such as USEC trading in an efficient market would have been absorbed within a day. Analyzed from any angle, the "reputational gain" theory collapses.

B. Certiorari is warranted because the decision below squarely presents conflicts under the First Amendment with decisions of this Court, other federal courts of appeal, and the Maryland Court of Appeals.

1. The government contends that "many" First Amendment protections were extended to petitioners, BIO 8, 14, as if constitutional rights were luxuries the government is permitted to dole out piece by piece as it sees fit. In fact, *none* of the necessary protections were provided.

The actual malice standard of *New York Times v. Sullivan*, 376 U.S. 254 (1964) was expressly rejected by the district court. App. 83a-87a. Since actual malice is an "elusive constitutional standard[]," *Harte-Hanks*, 491 U.S. at 686, whose meaning has only been developed "through the process of case-by-

case adjudication," *Bose v. Consumers Union*, 466 U.S. 485, 503 (1984), the district court's assertion that it applied a clear-and-convincing test to Section 10(b)'s *statutory* scienter element did not serve as a substitute for the *constitutional* requirements of *New York Times*. The court of appeals denied petitioners independent, *de novo* review of the entire record under *Bose*. App. 18a-19a. It reviewed only for clear error using a preponderance-of-the-evidence test in which it ignored all of the evidence negating falsity and fault.

Indeed, this lack of *de novo* review led the court of appeals to err in suggesting that petitioners had failed to raise the truth of their publications on appeal. (The government opportunistically pounces on this gift and claims now that petitioners did not contest falsity on appeal even though it never made such a claim below.) Nothing could be further from the truth. Petitioners' brief quoted federal appellate precedent that courts applying *Bose* must be "left with no apprehension on the issue of falsity" and included a section with the heading that respondent had "failed to prove, by clear and convincing evidence, that the Publisher and Author published materially-false statements with actual malice." Brief for Appellants 37, 40 (4th Cir. May 13, 2008). Furthermore, at oral argument, counsel for petitioners stated, "Under Bose review ... the Court would find that whether it looks at the falsity component or the fault or scienter component, that there's not clear and convincing evidence of any false statement. ... [E]ven if it accepted the District Court's finding of falsity, that the statement 'watch

the stock' was not made to the reporter ... [that is not] enough for actual malice." Dec. 2, 2008 Tr. 24:10-26:2.

The government asks on what basis the court of appeals would have had to "second-guess" the district court and reverse under *Bose*, BIO 17, but like the court of appeals the government simply ignores the contemporaneous state-of-mind evidence showing Stansberry's steadfast belief in the accuracy of the Report and Steven Wingfield's lack of any effort to correct it. Pet. 7-8, 28. As in *Bose* itself, the path to reversal does not require revisiting the credibility determinations of the district court but lies in the lack of clear and convincing evidence supporting the inferences it drew. Even if Stansberry was mistaken by believing that, like the defendant in *Bose*, he "knew what he heard," where his possible "misconception" of Wingfield's final words in an otherwise undisputed hour-long conversation is the "only evidence of actual malice on which the District Court relied," respondent has failed to prove fault with convincing clarity. 466 U.S. at 512-13.[2]

---

[2] The government tries to draw a tidy line between speech that "harm[]s reputation" and speech that "induce[s] stock purchases," BIO 19, and therefore misses the point of the end-run the court of appeals has created around existing First Amendment law. Pet. 27-28. Some speech does *both* – for example, a critical newspaper report on a public company that hurts its brand *and* leads readers to sell its shares. Under the ruling below, this report is entitled to no constitutional defenses if challenged under Section 10(b), while actual malice would be applied under defamation law.

2. The government errs in attempting to salvage the injunction by citing *Illinois ex rel. Madigan v. Telemarketing Assocs.*, 538 U.S. 600, 619 (2003) for the proposition that "properly tailored fraud actions" are distinct from the "broad prophylactic rule[s]" regarding fraudulent speech that this Court has repeatedly struck down. BIO 21. *Telemarketing Assocs.* does not support the injunction here – it only addressed standards for liability in common-law fraud actions and did not consider injunctive relief.

Respondent does not try to distinguish *Schneider v. State*, 308 U.S. 147 (1939), Pet. 21, 34, which supplies the authority that the government claims is lacking for a case where a provision regulating fraudulent speech is "valid" in substance but rejected because it establishes a prior restraint over the same subject matter. BIO 22. If the statute in *Vance v. Universal Amusement*, 445 U.S. 308, 316 (1980) was "procedurally deficient" as the government concedes, BIO 21, then so is Section 10(b), as it has been used here to "authorize[] prior restraints of indefinite duration on [disinterested speech regarding securities] that ha[s] not been finally adjudicated to be [fraudulent]." The suppression of speech before it is found to be unprotected is the special vice of *all* prior restraints as the government recognized in its brief in *Lowe*, Pet. 32, but which it now ignores when it tries to limit *Lowe* to its facts. BIO 22-23. Arguing that petitioners are not entitled to protections from prior restraints unless they qualify for the particular exemption under the Investment Advisers Act springs from the same faulty reasoning that declares *Near v. Minnesota*, 283 U.S. 697, 701 (1931)

irrelevant to the injunction here because the prior restraint in *Near* only targeted "malicious, scandalous, and defamatory" speech, not allegedly fraudulent speech. BIO 22.

The injunction permitted in *United States v. Bell*, 414 F.3d 474, 481 (3d Cir. 2005), BIO 21, prohibited publication of specific commercial speech previously found unprotected. Similarly, *Pittsburgh Press v. Pittsburgh Comm'n on Human Rel.*, 413 U.S. 376, 390 (1973), BIO 22, enjoined an ongoing advertising practice already deemed in violation of state law and did not proscribe *any* speech "before [a] final determination that [it was] unprotected." In contrast, the injunction in this case reaches *all* of the future speech of petitioners, *none* of which has been held to be unprotected.

3. The sweeping injunction is yet another reason why the government is mistaken that *Lubin v. Agora*, 882 A.2d 833 (Md. 2005), presents no conflict with this case. In *Lubin*, the Maryland court held that the Report (and petitioners' newsletters) could *not* be classified as commercial speech with less than full constitutional protections. App. 144a, 147a-148a. The district court, on the other hand, found that the Report (and the E-mail) *were* commercial speech and on that basis imposed liability and enjoined petitioners without applying any First Amendment defenses. App. 85a. Petitioners must assume in any future contempt proceeding in federal court that their speech will be classified as commercial speech and receive no constitutional protections, thus chilling expression the Maryland Court of Appeals placed *outside* of the commercial speech doctrine.

C. All legal and factual issues are preserved.

This case is an ideal vehicle for addressing the statutory and constitutional questions because the relevant issues were all raised below.

The controlling facts governing the "in connection with" requirement – that petitioners did not trade USEC shares or owe fiduciary duties to investors who did trade – were stipulated before trial. Brief for Appellants 8. Petitioners objected to the lack of actual malice protections at trial and sought independent appellate review over the entire record on the questions of both falsity and fault. *Supra* 8-9. They also raised constitutional defenses to the injunction. Brief for Appellants 55-57.

There is no merit to the government's contention that a constitutional challenge to an injunction is only properly presented if a determination has been made that the injunction is appropriate under Rule 65(d). The court of appeals established no such bar, and the constitutionality of the injunction having been both pressed and passed on below is ripe for review.

CONCLUSION

For the foregoing reasons, as well as the reasons set forth in the petition and supporting *amici* briefs, the petition for a writ of certiorari should be granted.

Respectfully submitted,

THOMAS C. GOLDSTEIN
AKIN GUMP STRAUSS HAUER
& FELD LLP
1333 New Hampshire Ave., NW
Washington, DC 20036

MATTHEW J. TURNER
14 West Mount Vernon Place
Baltimore, Maryland 21201

BRUCE W. SANFORD
Counsel of Record
BRUCE D. BROWN
LAURIE A. BABINSKI
BAKER & HOSTETLER LLP
1050 Connecticut Ave., NW
Washington Sq., Suite 1100
Washington, DC 20036
(202) 861-1500
bsanford@bakerlaw.com

Counsel for Petitioners

June 9, 2010